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Economic Intelligence Weekly 9 Apr 75 ER EIW 75-14

**Secret**
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# Economic Intelligence Weekly

**Secret**

ER EIW 75-14
9 April 1975

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# ECONOMIC INTELLIGENCE WEEKLY

## 9 April 1975



### Overview

**Growth Prospects in the Smaller OECD Countries** are less bleak than in the Big Six. Their aggregate real GNP probably will rise about 2% in 1975, compared with 2.8% in 1974 and with the 0.5% increase forecast for the Big Six. Their more expansionary policies and lesser dependence on industries hard hit by the oil crisis -- notably automobiles -- underlie these better prospects.

Switzerland is the only small country expected to suffer a fall in GNP this year. The sharp appreciation of the Swiss franc has cut foreign demand, and Bern is maintaining tight fiscal and monetary policies to curb inflation. Norway will post the most rapid growth, perhaps as much as 5%, with a tax cut and oil earnings boosting consumer expenditures.

Because of the higher level of real demand, inflation will not slack off as much in the smaller countries as in the Big Six. Iceland probably will experience a startling 40% rise in prices, while several countries, including Switzerland and the Netherlands, will face inflation of about 10%.

The composite current account defict of these countries will change little from the $12 billion posted in 1974. Because of their more rapid GNP growth, smaller countries will probably experience a $2-$3 billion deterioration in their current

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account balance with the developed West. This deterioration, combined with higher interest payments, probably will offset improvements in the small countries' aggregate balance with OPEC countries and non-oil LDCs.

**A Growing Number of LDCs** are being buffeted by the global economic downturn. Real growth in Taiwan, South Korea, and Hong Kong -- usually the LDC growth leaders -- is faltering because of weak US and Japanese demand for their manufactures. Other important non-OPEC LDCs such as Brazil, Mexico, Malaysia, and the Philippines are less affected, but growth will be substantially below their long-term average.

**Saudi Funds for the EC Common Borrowing Facility Will Be Requested** during the visit of EC Commissioner for Financial Affairs Haferkamp to Riyadh this week. The EC will probably seek pledges from other OPEC members later this spring. No problems are anticipated in funding the $1.5 to $2.5 billion facility, being set up to help finance the oil payments of EC members in distress. Although no loan requests have been received, Ireland may be an early borrower.

**Representatives of the Intergovernmental Council of Copper Exporting Nations** (Chile, Peru, Zambia, and Zaire) are meeting in Paris to discuss the effect on prices of recent cuts in exports of 10%-15%. They also will discuss proposals for buffer stocks and other measures required to raise long-term prices.

**The Association of Iron Ore Exporting Nations** formed last week will mainly be a forum for the exchange of information and will have no authority to set either prices or production quotas. Australia and Sweden joined nine developing countries in establishing the association. The London-based association accounts for about 30% of world iron ore production and 60% of world exports. Member nations, principally Venezuela and Brazil, supply about half of US iron ore imports; Canada, a nonmember, supplies most of the remainder. (Confidential No Foreign Dissem)

This issue contains a detailed explanation of the sources used in derivation of the statistics appearing on the indicator charts.

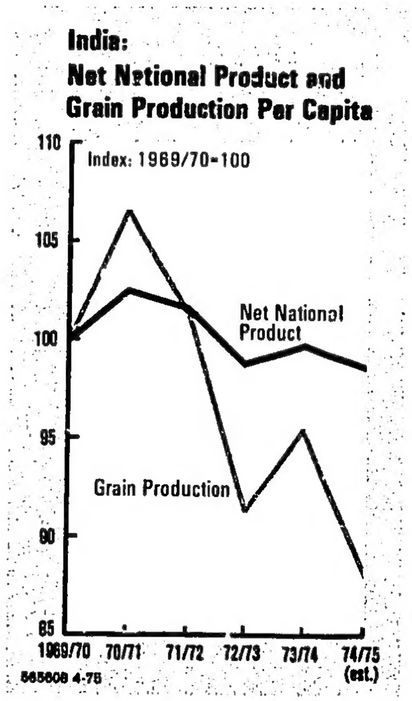
Articles

## INDIA: LISTLESS ECONOMIC PERFORMANCE

The Indian economy posted another disappointing performance in the fiscal year ending 31 March 1975. Agricultural and industrial production limped badly. Per capita grain production and real income declined for the third time in the past five years. Without a shift to more pragmatic government policies, India seems doomed to merely exist from one monsoon to the next and from one consortium meeting to another.

### Agriculture and Industry

A sub-standard wheat harvest last spring was followed by a poor summer monsoon. Grain imports soared; they will approach 8 million tons for the year ending this June. The United States is supplying well over half of this grain—4.1 million tons in commercial sales and 800,000 tons under a recent aid agreement. New Delhi has also purchased more than a million tons of US wheat for shipment after 30 June. Another poor monsoon next summer could push grain imports above this year's level; a good monsoon could cut imports to 3-4 million tons.




Immediate economic hopes remain tied to weather-dependent agriculture. Agricultural recovery, even to the level of four years ago, would stimulate an upturn throughout the economy. But New Delhi has failed to make the changes necessary to encourage recovery. More than a hundred river irrigation schemes remain tied up in interstate riparian disputes. Fertilizer production in April-December 1974 rose only 4% above the year earlier level, with the industry running at less than 60% of capacity. India's potential for reaching self-sufficiency in rock phosphate on the basis of the massive deposits discovered eight years ago remains unfulfilled. The recent tightening of controls on the private wheat trade hurts production incentives by cutting off successful wheat farmers from profitable grain-short markets elsewhere in the country.

Industrial production in 1974 grew 2%-3%, far below the 6% average of the last two decades. The curtailment of public investment, caused by inflation, lessened the demand for heavy industrial products. Light manufactures suffered from shortages of electric power, transport bottlenecks, and restrictions on imports of equipment and raw materials. In an effort to stimulate output, New Delhi loosened some controls on industry—for example, allowing large firms to expand capacity. These moves have been *ad hoc*, however, and have been applied only to the most severely affected industries. Similar liberalizations in the last 20 years have always been rescinded when conditions improved.

**Foreign Trade**

The sharp increase in petroleum prices prompted New Delhi to hold oil imports down to 340,000 b/d in 1974, or slightly below the previous year. The resultant energy gap cannot quickly be covered by conservation, changeovers to alternative energy sources, or increased domestic production. Offshore oil exploration, while promising, will not make a significant contribution to energy resources for several years.

In 1974, India's foreign trade deficit nearly tripled to an estimated $1.6 billion. A 48% rise in imports dwarfed a 22% growth in exports. Outlays on three essential imports—petroleum, foodgrains, and fertilizer—accounted for the entire increase. India obtained nearly $700 million from the IMF in 1974, rescheduled $196 million in debts, and obtained about $1.7 billion in new aid. The same level of aid will be more difficult to obtain this year because many donors have their own balance-of-payments problems. New Delhi will have to take some combination of the following steps: dip into foreign exchange reserves ($1.3 billion), increase IMF borrowings, press for debt rescheduling, or, as a last resort, further curtail imports.

**Policy**

The adversity of recent years and the shock of the oil crisis appear to have edged the government toward pragmatism. At least a new emphasis is apparent in government rhetoric—on the need to eliminate bottlenecks, increase agricultural output, and speed up the licensing of new industrial ventures. India's leadership, however, remains committed to socialism, viewing the private sector as a selfish and corrupt barrier to economic development. Income redistribution is still more important to New Delhi than growth. Major policy changes to spur growth appear unlikely. (Confidential)■

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## ITALY: KEEPING A STEP AHEAD OF TROUBLE

With output down, unemployment rising, and inflation maintaining a torrid pace, the Christian Democratic Party of Prime Minister Aldo Moro probably will suffer further setbacks in the regional and local elections this June. The major bright spot – a sharp drop in the current account deficit – is not apt to impress the voters. Workers increasingly are expressing discontent through strikes for more generous fringe benefits, pensions, and unemployment compensation. Another center-left coalition probably will be put together after the elections, following lengthy negotiations.

### Balance Sheet for 1974

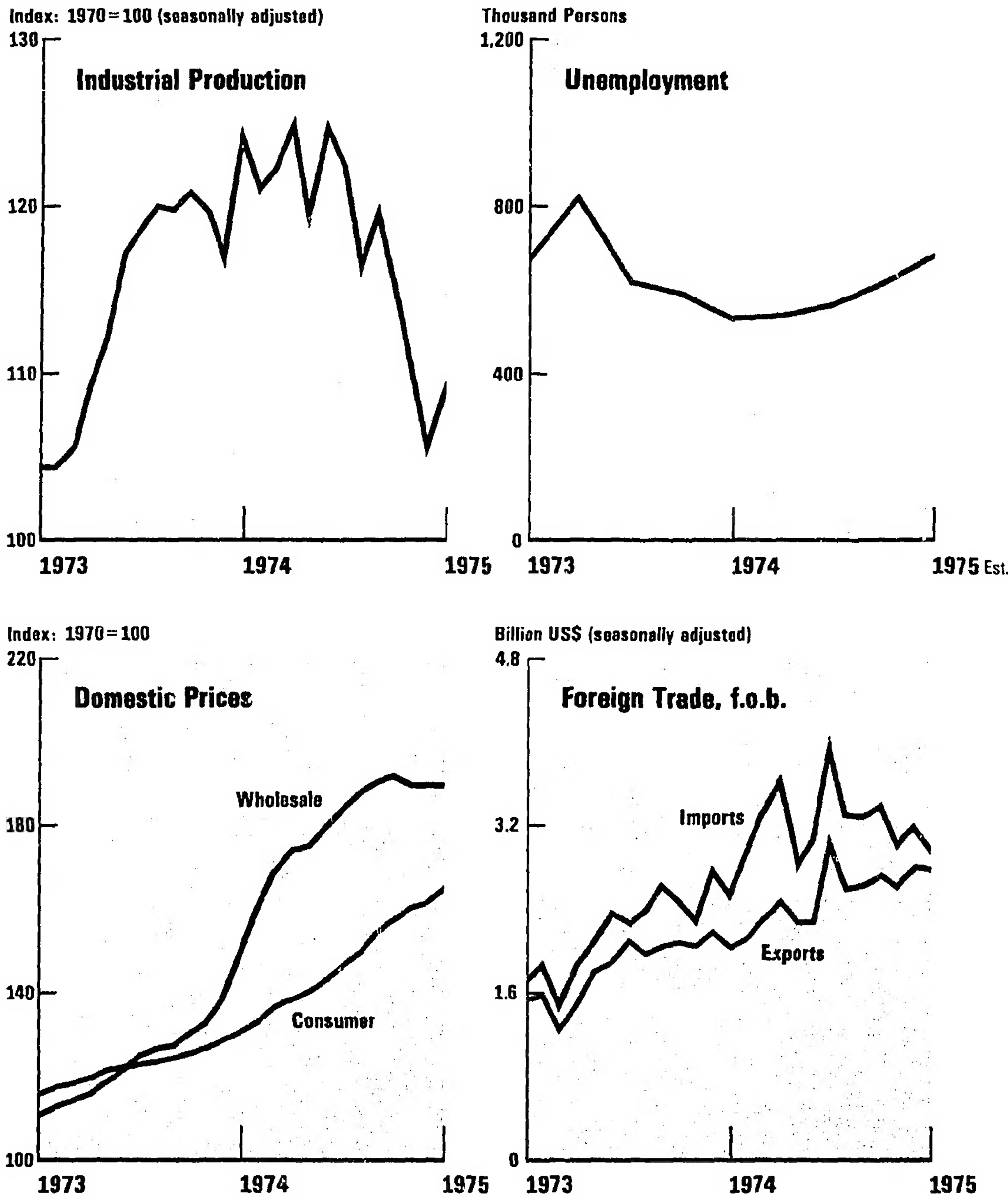
In 1974, Italy once again muddled through, escaping the economic and political disaster widely predicted in the Western press. After tortuous compromises, the coalition government came up with an austerity program in July that greatly improved the trade account. The quadrupling of oil prices caused a $2.1 billion deficit in the first quarter; the fourth quarter deficit had narrowed to $1.3 billion. More important, the austerity measures enabled Italy to scrape together $6 billion in credits from foreign official sources. This was enough, along with some private borrowing, to avoid dissipation of reserves despite the $8 billion current account deficit.

The credit squeeze and tax hikes, principal features of the austerity program, led to a precipitous drop in industrial output in the second half. While other sectors were less seriously affected, GNP began to slide after midyear. As a result, growth for the year was held to 3.6% – still one of the highest rates in Western Europe – compared with a 5% long-term average. The number of workers on short hours or without jobs rose in the second half, adding to already substantial labor unrest and straining the union-government truce arranged in early 1973. In spite of weakening demand and slower growth in wholesale prices, inflation of consumer prices accelerated to a 28% annual rate in the second half because of sizable increases in wages, indirect taxes, and prices of petroleum products.

### Dispiriting Growth Prospects

Italy probably will be the only country among the Big Six to suffer a drop in output in 1975. We anticipate a 1% decline in real GNP because Italy's shaky credit rating will encourage Rome to move very cautiously toward reflation. Even the Communist opposition is advocating fiscal moderation. The Socialists, likely

# ITALY: SELECTED ECONOMIC INDICATORS

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to gain in the June elections, may demand economic stimulation as the price of their continued participation in the government. Measures taken after midyear probably would have little effect on economic growth in 1975.

In recent months, the government has acted more to check the decline in output than to stimulate an upswing. Preferential central bank rediscounting for banks that reduce interest rates and the removal of the import deposit scheme last month should help hold the drop in fixed investment in 1975 to about 5%. Recent increases in appropriations for public construction, subsidies to agriculture and exports, and worker income supplements do not make the 1975 budget much more expansionary than originally planned. The added spending is supposed to be covered by increases in postal rates and by tax receipts beyond the amount initially forecast. As a result of the tax reform implemented at the start of 1974, which featured income tax withholding and better enforcement, collections have improved considerably.

**Ministering to Labor**

Although displeased with the government's hesitant reaction to the recession, workers probably will fare better than business this year. Union grumblings already have induced the national federation of industries and the government to greatly improve cost-of-living adjustments, family allowances, and income maintenance payments. Renegotiation this coming autumn of triennial labor contracts affecting half the industrial labor force is sure to give an added push to wages.

Concessions to labor will force up industrial costs and keep inflation boiling in 1975. We anticipate a 20% rise in consumer prices, about the same as in 1974.

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**Wanted: $6 Billion in Foreign Capital**

Barring a protracted political crisis, particularly one that led to increased Communist influence in the government, Italy should be able to finance another large current account deficit this year. We expect a deficit of $6 billion, down $2 billion from 1974. Lower international commodity prices should improve Italy's terms of trade, and the recession probably will cause a slight decline in import volume. We assume that the lira will be allowed to depreciate enough to keep exports competitive despite the lofty inflation rate.

Political turmoil could upset an already shaky financial situation by

- drying up credit from private and official sources abroad,
- provoking a massive flight of domestic capital, and
- cutting off the repatriation of capital, which began in the second half of 1974 because of Italy's credit restrictions and high interest rates.

In any event, prospects of obtaining large loans directly from OPEC states are poor. President Leone's credit-seeking trip to Saudi Arabia in March was a disaster, and negotiations with Iran appear to be hopelessly tangled. Financing of the current account deficit thus will require large receipts from such petrodollar recycling mechanisms as the IMF facility and the prospective EC and OECD facilities. If such assistance is not forthcoming – or if a shift to the left scares off capital – Rome will have to curb imports and dip into its $3 billion foreign exchange reserves. (Confidential No Foreign Dissem)■

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## RESURGENCE OF THE INTERNATIONAL BOND MARKET

The decline in short-term interest rates from the record levels of mid-1974 has sparked a recovery in the international bond market.

New international issues totaled $3 billion in the first quarter of 1975, more than double the amount of a year earlier. Most of the funds were raised by private borrowers from countries without crushing financial problems, such as France, Canada, Japan, and Austria.

### Forces at Work

Investors are attracted by the high returns on the bonds and by the opportunities for diversification of portfolios. The bonds typically carry interest rates of 9% at a time when short-term Eurodollar deposit rates have plummeted to about 7% because of recession and easier money. Bond purchases also permit investors to acquire assets in countries that have effectively halted the inflow of short-term capital. In Switzerland, to take the extreme example, new foreign bank deposits are subjected to a 46% negative interest rate. Controls on short-term capital movements have been imposed to keep the inflow of speculative funds from excessively appreciating the currencies.


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Recent bond issues reflect the preference of investors for such currencies as the mark and the Swiss franc. Issues denominated in marks, for example, made up one-third of the first quarter total, compared with one-tenth in 1974; the share of dollar-denominated issues fell from two-thirds to about one-half.

Private borrowers are rushing new issues to market to beat anticipated increase in government borrowing later in 1975. French and Japanese borrowers also have acted promptly because their governments are moving to limit appreciation of the currencies by curbing inflows of long-term capital. New French issues totaled $690 million in the first quarter, enough to cover more than half of the current account deficit. [redacted]

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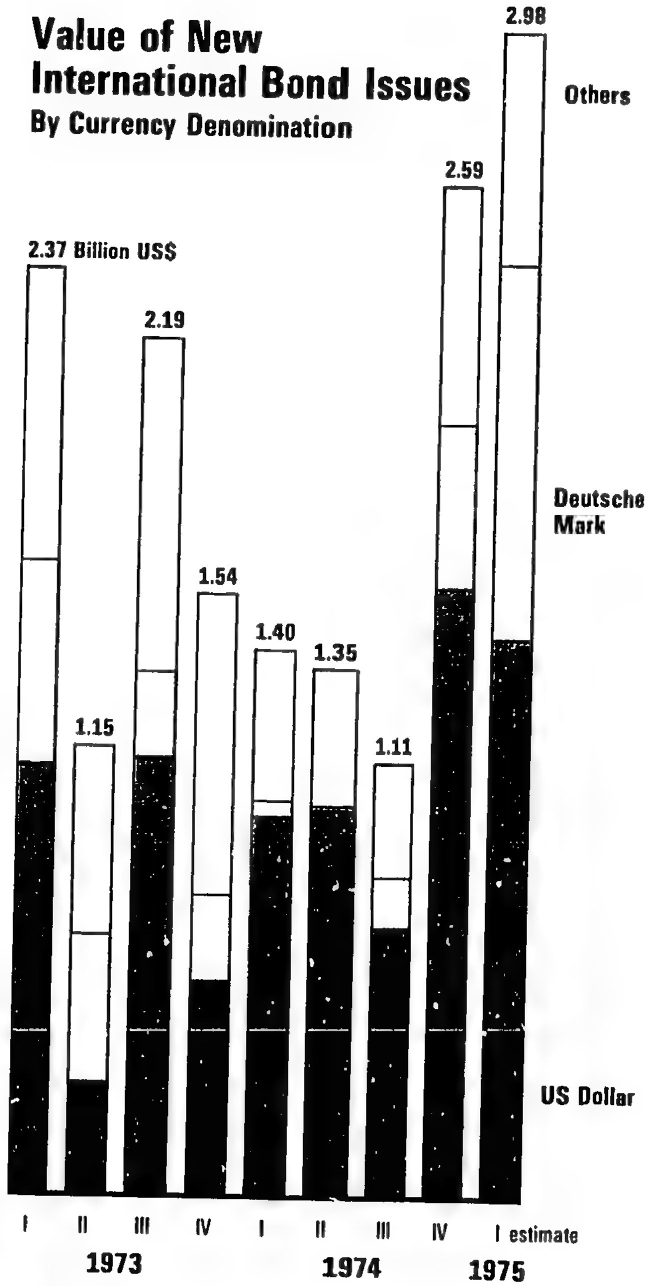


## Role of OPEC Countries

A substantial portion of new issues clearly has gone into the portfolios of OPEC countries, mainly Saudi Arabia and Kuwait. Middle Eastern banks have become prominent managers and underwriters of international bond issues. Borrowers are even offering issues denominated in Arab currencies: two issues totaling $45 million and denominated in Kuwaiti dinars were floated in the first quarter, and the

International Bond Issues
January-March 1975

Million US $

| Country of Issue | Currency Denomination: US Dollar | Deutsche-mark | Swiss Franc | Other | Total |
|---|---|---|---|---|---|
| **Total** | **1,430** | **960** | **175** | **420** | **2,985** |
| France | 300 | 240 | 25 | 125 | 690 |
| Japan | 185 | 70 | 60 | 10 | 325 |
| Canada | 310 | .... | .... | 100 | 410 |
| International organizations | 435 | 110 | .... | 45 | 590 |
| Other | 200 | 540 | 90 | 140 | 970 |

Asian Development Bank plans to issue $14 million worth of Saudi riyal-denominated bonds this year.

Arab bond purchases are an encouraging sign that oil producers may gradually lengthen the maturities of their massive portfolios and thereby reduce the potential for disruptive capital movements. So far, however, the purchases are a drop in the bucket in comparison with the estimated OPEC current account surplus of $57 billion in 1975. In any case, OPEC investors probably will show little interest in issues originating in the countries with the most serious payments problems. (Confidential)■

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## VENEZUELA: NO FINANCIAL BONANZA

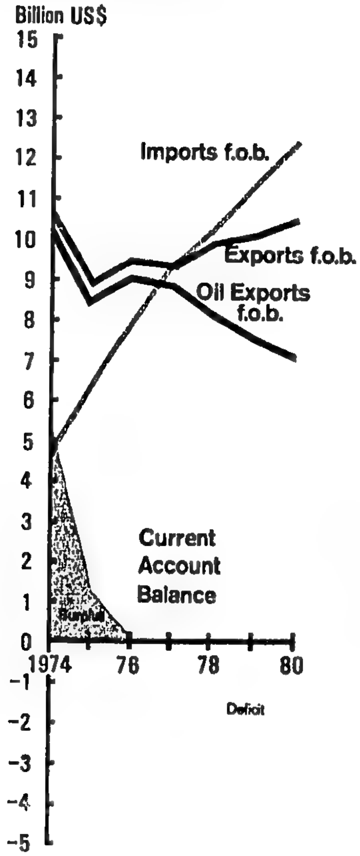
Venezuelan oil earnings, now at peak, still are not large enough to make Caracas willing to bankroll major LDC commodity support schemes or other major foreign projects. Over the next few years, rapid growth in imports almost certainly will put the current account in the red. Thus, Caracas will continue its push for the highest possible oil prices within all international forums.

### Exports

Oil export earnings will gradually drop from their high of $10.3 billion in 1974 because of the government's oil conservation policies. Plans call for production of only 2.0 million b/d in 1980, down from nearly 3.0 million b/d in 1974.

# VENEZUELA

## Projected Trade and Current Account Balance

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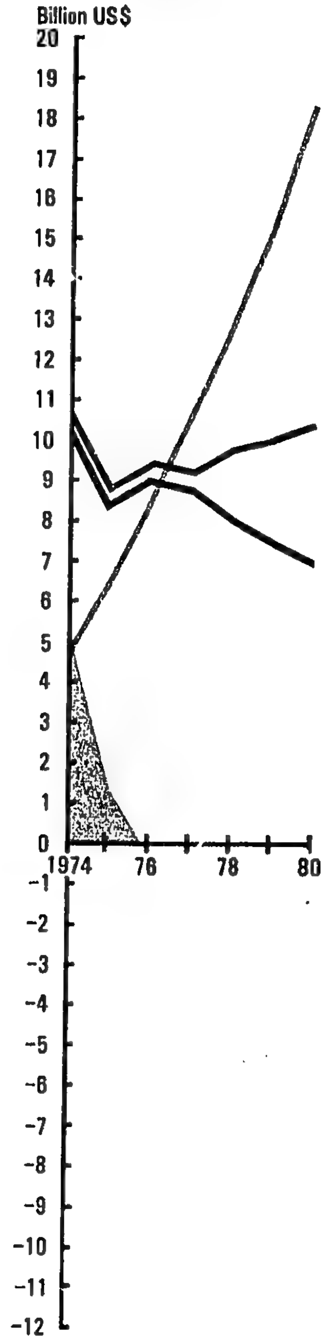
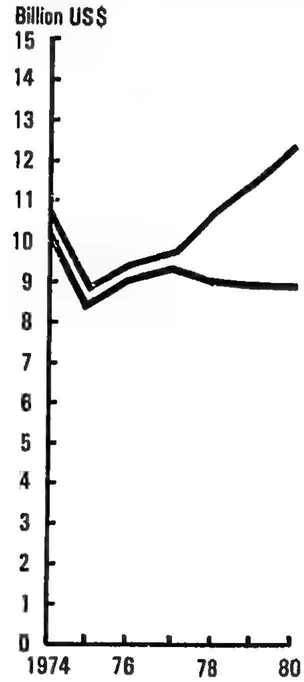
## Alternative Projection of Current Account Balance [1]




## Alternative Projection of Export Earnings [2]




*1. Assuming real import growth of 20% annually in 1976-80.*

*2. Export earning if crude oil output is maintained at 2.4 million b/d through 1980.*

Domestic oil consumption will grow more rapidly toward the end of the decade as the petrochemical industry expands. By 1980, exports of petroleum and petroleum products will slip to about 1.5 million b/d, earning only $7 billion, assuming price increases of 8% and 5% in 1976 and 1977 and constant prices during 1978-80.

The composition of oil exports is not expected to change substantially by 1980. Now, about two-thirds of exports are crude; refined product exports consist mostly of residual fuel oil, priced below crude. Studies on how to increase the value of oil exports are only beginning, and feasible projects will not be completed until after 1980.

If Venezuela maintains its industrialization schedule, non-oil exports – particularly petrochemicals, steel, and aluminum – will expand rapidly after 1977, reaching about $3.5 billion by 1980. At this rate, they would essentially offset the anticipated drop in oil exports.

**Imports**

With the sudden surge in foreign exchange in 1974, imports jumped about 65% (approximately 25% in real terms) to $4.6 billion. The volume of imports in 1975 will probably rise at about the 1974 rate. Assuming a 12% price increase, the value of imports will move up to $6.4 billion. This rapid growth reflects the large import requirements of extensive development in heavy industry. Rising consumer incomes also will call out increased imports of finished consumer goods plus raw materials and intermediate products for import substitution industries.

We believe, however, that real import growth will drop to 15% in 1976 and to 10% in each of the following years as the government tightens restrictions on imports to postpone sizable trade deficits. A 10% annual increase in the volume of imports probably is required to support real economic growth of 7%-8%.

**Current Account Balance and Foreign Aid Implications**

Given these projections and a continuation of the usual deficit in freight and insurance services, the current account surplus will end in 1977. Considering only the current account, foreign reserves will peak at about $9.0 billion in 1976; as mounting trade deficits boost the current account deficit, foreign reserves will begin to drop and by 1980 will be depleted. With these prospects in view, we expect Venezuela to back away from expensive LDC commodity support schemes and major foreign aid commitments. Even in its present affluent situation, Caracas has

been conserving its funds for use in building up latent export industries. To finance commodity support schemes, only short-term loans totaling $40-$80 million were offered to Central America to finance a coffee stockpile, with repayment on commercial terms.

**Alternative Projections**

The government could adopt other policies, but trade deficits are still likely to develop. Caracas could allow imports to grow more rapidly, as much as 20% annually, while pushing development projects in the hope that in the 1980s new non-oil exports would reverse the rise in the trade deficit.

Alternatively, oil production could be maintained through 1980 at about 2.4 million b/d, the expected 1975 rate. Venezuela probably has the capacity to sustain production at this level. But toward the end of the decade this policy could increase the stress on OPEC in coping with the problem of prorationing oil production. With higher export earnings, Caracas probably would allow a 20% increase in imports annually in 1976-80. In either case, trade deficits would develop by 1977 and foreign reserves would be depleted by 1979. Venezuela's capability to provide foreign aid in the 1980s would be negligible.

*Note*: Assumptions underlying the projections in this article include: (a) average nominal oil prices in 1975 will equal prices on 1 January 1975, in 1976 will rise by 8%, and in 1977 will rise by a further 5%; (b) import prices will rise by 12% in 1975, 9% in 1976, and 6% in 1977; (c) export and import prices will be constant in 1978-80; (d) freight and insurance outlays will equal 12% of the f.o.b. value of imports; and (e) investment income will equal 8% of the value of assets held abroad. (Confidential)■

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## SOUTH VIETNAM: ECONOMIC STRAINS

The economy of South Vietnam's capital and Delta is showing increasing strains from the recent military reverses.

Until this past week, developments in the now-abandoned northern regions evoked little business reaction in more densely populated areas. Most South

Vietnamese were unaware of the extent of the losses and the immediacy of the threat to their own well-being. The tales of failure and despair told by newsmen, refugees, and soldiers entering Saigon and other southern cities in recent days, however, are having an unsettling effect on all sectors of the economy.

**Prices and Monetary Holdings**

Growing popular demand for greater cash balances has led to falling commodity prices. Merchants are unloading goods to acquire cash and to avoid losing large inventories to the Communists. Farmers around Saigon and in the Delta are selling unusually large amounts of rice, livestock, and other foods for similar reasons. Consumers, for their part, are avoiding purchases of unnecessary goods to have available as much cash as possible for emergency needs.

Banks have been hit with unusually heavy withdrawals. The run has not yet reached panic proportions but is large enough that banks are reportedly refusing to allow withdrawal of accrued interest. The National Bank of Vietnam has managed so far to keep the lid on by promising to guarantee all commercial deposits while warning of the dangers of keeping large, vulnerable cash holdings.

Much of the increase in the money in circulation has gone to purchase dollars or gold. The black market dollar rate – near 820 piasters to the dollar before the recent turn of events – soared from 900 on 31 March to more than 1,700 on 4 April. (The official rate is 725 piasters to the dollar.) Gold prices are now up over $235 an ounce, compared with $195 an ounce as late as 24 March.

**Business and Commerce**

Rapidly declining business confidence in the future of non-Communist South Vietnam portends a general disintegration of the commercial and industrial sectors. Within the important Chinese business community the feeling is one of dismay, fear, and distrust of the government and the army. Many Chinese are planning to get out of the country. In addition to the other strains, they complain that the ever-longer curfews contribute little to security and severely limit business activities.

Foreign businesses have been the first to abandon ship. Many have already sent dependents out and some are evacuating expatriate principals as well. Most recently, Mobil and Pecten Vietnam (a Shell subsidiary), the two oil companies

doing exploratory drilling off the coast of Vietnam, at least temporarily shut down operations and evacuated all foreign personnel. The Bank of America, First National City Bank, and Chase Manhattan have also prepared for evacuation of their expatriate staffs, and this has encouraged a particularly bitter reaction among native bankers as psychologically ruinous.

### Stocks of Necessaries

Nevertheless, Saigon's most important needs -- food, fuel, and shelter -- can be met from supplies on hand for some time. Official rice stocks, for example, are high enough at 150,000 tons to feed the 3 million people of the Saigon-Gia Dinh metropolitan area for three months. Over the longer run the many refugees that will find their way into Saigon and the military reinforcements that will be called upon to defend the city will increase pressures on supplies of food and other essential goods. Those pressures could become critical if the Communists cut off access to rice from the Delta and supplies moved up the Mekong and Saigon Rivers. (Confidential)■

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## Notes

### Romania: Testing US Trade Climate

Minister of Heavy Industry Ioan Avram arrived in the United States on 6 April to discuss the purchase of equipment for the 1976-80 economic program. Among the items Bucharest may buy are petroleum machinery, equipment for producing roller bearings and vehicle transmissions, and naval construction equipment. Avram has indicated, however, that prospects for purchases are poor unless the United States restores ExIm Bank financing, which was suspended under the Trade Act of 1974. Following authorization for ExIm credits in 1971, Romania increased its import of US machinery and equipment from $12 million to $88 million in 1974. (Confidential No Foreign Dissem)

### South Africa: Uranium Enrichment Plant

According to Prime Minister John Vorster, a pilot uranium enrichment plant went into operation on 5 April. The plant, reported in October 1973 to cost $120 million, will be used to gain experience with South Africa's secret enrichment

process, which may be a variation of a West German jet nozzle process. [redacted] 25X6

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25X6 [redacted] Abundant uranium ore and cheap electricity will permit South Africa to actively compete in the world enrichment market, estimated to be worth $5-$10 billion annually in the 1980s. (Unclassified)

## Publication of Interest*

**Trade and Payments Trends of Non-OPEC LDCs**
**(ER IM 75-7, April 1975, For Official Use Only)**

This memorandum examines trade and payments developments in non-OPEC developing countries in 1974 and assesses their international economic prospects for 1975.

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* Copies of this publication may be ordered by calling [redacted] Code 143, Extension 7234. 25X1A

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